07-Dec-2022

United Natural Foods, Inc. (UNFI)

Q1 2023 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning. My name is Devon, and I will be your conference operator for today. At this time, I would like to welcome everyone to the UNFI First Quarter Fiscal 2023 Earnings Call. All lines have been placed on mute to prevent any background noise. After the speakers' remarks, there will be a question-and-answer session. [Operator Instructions] Thank you.

Vice President of Investor Relations, Steve Bloomquist, you may begin your conference.

Steven J. Bloomquist

Vice President-Investor Relations, United Natural Foods, Inc.

Good morning, everyone. And thank you for joining us on UNFI's first quarter fiscal 2023 earnings conference call. By now you should have received a copy of the earnings release issued this morning. The press release and earnings presentation, which management will speak to, are available under the Investors section of the company's website at www.unfi.com. We've also included a supplemental disclosure file on Microsoft Excel with key financial information.

Joining me for today's call are Sandy Douglas, our Chief Executive Officer; and John Howard, our Chief Financial Officer. Sandy and John will provide a strategy and business update after which we'll take your questions.

Before we begin, I'd like to remind everyone that comments made by management during today's call may contain forward-looking statements. These forward-looking statements include plans, expectations, estimates, and projections that might involve significant risks, and uncertainties. These risks are discussed in the company's

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earnings release and SEC filings. Actual results may differ materially from the results discussed in these forward-looking statements.

And lastly, I'd like to point out that during today's call, management will refer to certain non-GAAP financial measures. Definitions and reconciliations to the most comparable GAAP financial measures are included in our press release and at the end of our earnings presentation.

I'd ask you to turn to slide 6 of our presentation as I turn the call over to Sandy.

J. Alexander M. Douglas

Chief Executive Officer & Director, United Natural Foods, Inc.

Thank you, Steve. And good morning, everyone. We appreciate you joining us for our first call of our new fiscal year. Our focus continues to be executing our Fuel the Future strategy underpinned by our priority of bringing more value to our customers, improving the way we partner with suppliers, creating unmatched clear opportunities for our associates, and supporting our communities, and the planet.

As you will have seen in our release, we started the fiscal year with a nearly 8% increase in sales as more customers are buying more categories from UNFI than ever before. The competitive advantages I laid out in September, namely our scale, vast distribution network, data and analytics capabilities, diversity of customers and suppliers, and growing management talent, have led to a strengthening customer pipeline.

We are investing in an elevated level across the company to better serve our customers, including training and upskilling for our customer support and sales teams, and we're beginning to see early results. We continue to gain share of our addressable wholesale market, and we're confident that we'll be adding more new customers, and new categories and services with current customers during the back half of this fiscal year.

Our sales growth this quarter also reflects a complex operating environment characterized by persistently high levels of food inflation and elasticity as consumers increasingly look for ways to stretch their household budgets translating into unit weakness across much of the industry. Changes to the grocery landscape will inevitably continue, shaped by both macroeconomic factors such as inflation and supply chain as well as changing and evolving consumer preferences.

For the past two years UNFI's customers have had to reassess and adapt nearly every facet of their operations, and we've done that right alongside them. Our customers face growing competition and changing consumer preferences based on the pressures that consumers are experiencing. None of these are unique to our customers, but we're ensuring that our customers can increasingly count on us to be their partner of choice as they focus on the trends that really matter. In this changing environment, we believe UNFI is well-positioned for further value creation. Leveraging our scale, diversification, private brands, and professional services portfolio that helps our customers drive sales and save money are all drivers of differentiated capabilities that enhance connectivity and market visibility for both our customers and suppliers.

Among trends, we know many consumers are seeking value, which doesn't always mean merely the lowest price or cheapest option. Our merchandising programs help deliver this value across the store in ways such as new digital shelf tags, and digital coupons, strategic buying events and shows as well as our private brand program.

Through partnering closely with stakeholders across the value chain, UNFI is helping drive more favorable pricing for our customers and increase volumes for suppliers into and with our nationwide footprint of 30,000-plus customer locations. We strive to be their partner of choice known for our commitment to leverage our scale and

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expertise to help them succeed and compete. All of this translates into increased sales and a healthy customer pipeline.

Higher sales drove a strong increasing gross profit dollars this quarter, which combined with diligent management of our operating expenses, contributed to a 3.5% year-over-year increase in adjusted EBITDA. One overarching theme you heard me speak about before is our commitment to improving capabilities from serving customers to partnering with suppliers. This includes enhancing operational performance, and improving reliability and speed for our customers. We have several strategic initiatives underway aimed at enhancing customer and shareholder value by doing just that. And during the quarter, we were pleased to see examples of strong progress across the company, including improving fill rates, outbound quality and expense rates.

We're managing our SG&A spending well, and have shifted existing dollars into higher strategic priorities aimed at driving growth and profitability, including growth opportunities in our services platform, and added resources in digital and business transformation to improve the way we serve customers. This quarter, we strengthened our center-led, regionally focused merchandising teams who will be helping develop local programs and solutions that leverage our national scale.

Within operations, our facilities are staffed better than at any point since the start of fiscal 2022, and our capabilities are improving as newer associates gain experience and increase their productivity levels. Efficiency and fill rates are increasing, and we believe these trends will generate higher service and operating efficiency levels, and customer satisfaction while continuing to favorably impact our operating expense rate in the remainder of the year. I'm especially encouraged by and grateful for the many unsolicited comments that we've received from our customers commending us on the improvement and how we're servicing their stores. We have much more work to do, but it's encouraging to see the investment in continuous improvement beginning to pay off.

Going forward, we expect technology and automation investments that we introduced on our last call to be a meaningful growth and profitability enabler in the years ahead. These investments are expected to help us efficiently manage the anticipated higher volumes that we plan to capture as we gain an increasingly larger portion of the approximate $140 billion addressable market that we've outlined previously.

Let me come back to two areas in which we believe that UNFI has a real and growing competitive advantage, namely private brands and professional services, where each continues to do well on both the top and the bottom line. As I touched upon a moment ago, private brands is one way that consumers are finding value in the store. And in Q1, our private brand sales growth outpaced total industry private brands growth. Our growth aspirations we discussed at our last Investor Day for our brands remains unchanged. We've recently brought additional brand and commercial experience to the brand's leadership team, and we're optimistic that the value proposition we bring to our customers will significantly improve as we go forward.

At the same time, we once again achieved double-digit adjusted EBITDA growth in our professional services business by meeting the ever-evolving needs of our customers through tailored solutions that help them grow faster and run their businesses more efficiently. We remain focused on growing gross profit dollars and further improving our supply chain execution which will enable us to over time grow adjusted EBITDA and capital returns faster than sales. As the external environment continues to change, we're keenly focused on getting better at what we do so we're better able to service our customers and help them meet their business goals.

We have a high degree of confidence in our ability to capitalize on the growth opportunities we see with both existing and new customers by continuing to execute our Fuel the Future Strategy. We have a large, diverse and vibrant customer base that continues to see us demonstrate each and every day our commitment to helping them

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succeed, and we believe our focus on continuous improvement will lead to growth, and perpetuate the flywheel effect that I've described in the past.

Finally, we continue to be focused on our planet and the communities we serve. This quarter, we partnered with the Climate Collaborative to launch a series of educational sessions informed by our recent published Climate Action Guide for businesses exploring the steps that we can take together with our value chain community to address climate change and achieve our science-based targets by 2030.

To further support these goals, we are nearing completion of our largest rooftop solar array to date at our Howell, New Jersey distribution center, which is expected to go live by the end of this year. We also announced a partnership with Square Roots that will allow us to colocate indoor farms at select distribution centers across our network with the first planned for Prescott, Wisconsin in 2023. These indoor farms are an example of an innovative solution designed to strengthen our supply chain and give back days of freshness to consumers while reducing waste, lowering greenhouse gas emissions, and advancing sustainable growing practices. We plan to release our next ESG report early next calendar year, and we'll provide some highlights on our next call. We view this work as integral to our operations and our growth agenda.

Growing and getting better at what we do is what excites and motivates our entire leadership team, and I'm pleased with the progress we're making. Importantly, our solid start to the year keeps us on track to deliver our full-year guidance provided in September. As we look to the future, UNFI is on a path to creating significant shareholder value by continuing to win more customers and new business across all aspects of our addressable market.

Adding more customers and more categories also creates more value for our suppliers, which helps them invest more significantly over time in our customers. At the same time, we are operating our business in an increasingly more efficient manner from our distribution centers and services platform to our retail stores to our corporate offices. Taken together, we are confident this virtuous cycle will lead to greater profitability, stronger cash flows, and outsized returns on invested capital for our shareholders.

With that, I'll turn the call over to John for detail on our financial results, capital structure, and outlook. John?

John W. Howard

Chief Financial Officer, United Natural Foods, Inc.

Thank you, Sandy. And good morning, everyone. As you heard from Sandy, in the first quarter, we delivered increased sales, gross profit dollars and adjusted EBITDA, all of which keeps us on pace to meet the full-year outlook we provided in September.

Turning to slide 8, let's start with net sales which grew by nearly 8% in the first quarter and totaled $7.5 billion setting a new first quarter record. Wholesale growth included inflation net of elasticity as well as new customers and new categories with existing customers partially offset by a decline in unit volumes.

In Wholesale, we delivered widespread sales growth across all three primary channels, which grew by close to 8% on a combined basis. This includes incremental volume from new customers added over the last year, additional categories and new store openings in Supernatural, and increased item and categories penetration with existing customers. As Sandy mentioned, we expect contributions from new customers and existing customer expansion to increase in the back half of the year.

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Sales in our Retail business increased by about 2%, which was driven by higher average unit retail pricing. Our CUB banner, which remains the market leader in the Twin Cities, continues to generate strong sales in its pharmacy which shows the trust and confidence shoppers place in the brand. We're also continuing to grow our e-commerce business at CUB as we look to migrate consumers to a new and enhanced platform.

Flipping to slide 9, adjusted EBITDA totaled $207 million, up 3.5% over last year's first quarter. Our gross profit dollars prior to the LIFO charge in both years increased by $64 million over last year's first quarter, and gross profit rate declined to 20 basis points driven by changes in both wholesale customer and product mix. Within our Retail segment, gross margin rate for Q1 was flat compared to last year. Our operating costs as a percentage of sales improved sequentially from the fourth quarter and were flat compared with the first quarter of last year. We continued to invest in distribution center and transportation labor to provide the highest possible service levels for our customers, and we also experienced inflationary pressures on certain fixed occupancy-related expenses such as utility and energy costs.

As a result of the people-first initiatives we have previously spoken about, we continue to drive improved vacancy rates. As our more recent hires continue to ramp up to the productivity standards of more experienced associates, we expect to continue to see a favorable impact on our service and operating efficiency in the back half of the year.

Within our Retail segment, adjusted EBITDA was down about $2 million compared to last's first quarter. This decline was largely the result of an incremental health and welfare payment, and startup costs associated with three new Shoppers stores we reacquired and subsequently reopened. Overall, the team did a good job balancing and promotional spending, and continues to work on various cost-saving initiatives that we believe will contribute positively to the remainder of the year. Our GAAP EPS was $1.07 in the quarter, which included a $0.34 pre-tax LIFO charge as well as several smaller pre-tax items. Adjusting for these items and removing a favorable GAAP tax benefit related to the vesting of employee stock awards, our adjusted EPS totaled $1.13, up 2.7% from last year's $1.10. This increase included a $0.04 or roughly 3.5% headwind from lower non-cash pension income that we discussed on our last call as we look to de-risk our pension plans.

Moving to slide 10, we finished the quarter with total outstanding net debt of $2.49 billion, a $378 million increase compared to year-end. This reflects an investment in working capital as we add inventory going into the holiday selling season in support of our customers as well as the impact of inflation. This expected seasonal increase in working capital should largely convert to cash in the second quarter. Given the higher debt level, our net debt to adjusted EBITDA leverage ratio increased compared to year-end to 3.0 times. On a year-over-year basis compared to last year's Q1, this leverage ratio declined by about 0.1 turn.

Shortly after the quarter ended, we paid down approximately $253 million of net debt with the proceeds from the A/R monetization program I discussed on our last call, which would equate to about 0.3 times on our adjusted EBITDA to net debt leverage ratio. This had a corresponding effect of removing approximately $250 million in qualified accounts receivable from our balance sheet. These changes will be reflected in our Q2 balance sheet and will contribute to lowering our leverage ratio and overall cost of funding our business.

We still expect our year-end adjusted EBITDA leverage ratio to be lower than last year's 2.6 times driven by net debt reduction over the coming three quarters, including the benefits from the A/R monetization program and higher full-year adjusted EBITDA. We're currently expecting to finish fiscal 2023 near the midpoint of the 2.0 to 2.5 times target we previously provided.

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During the quarter, we also made initial purchases of UNFI's stock under our new stock repurchase program, buying 339,000 shares at an average price of $35.85 for a total cost of approximately $12.2 million, including fees and commissions. As we continuously work to create value for shareholders, we will look to opportunistically repurchase shares under our $200 million authorization.

Turning to slide 11. As stated in our press release, we are affirming our full-year outlook for fiscal 2023. This includes our expectations for net sales of $29.8 billion to $30.4 billion, adjusted EBITDA of $850 million to $880 million, and adjusted EPS of $4.85 to $5.15 per share. Our outlook for fiscal 2023 capital spending remains at $350 million, with a portion of the total spend going towards automation. We're finalizing the initial set of DCs based on existing volumes, our expectations toward growth across our markets, and the efficiency benefits that we expect will deliver strong financial returns above our cost of capital. The forecasted after-tax IRR from the first automation installation is over 2 times our estimated cost of capital.

In summary, as outlined on slide 12, we're pleased to reaffirm our full-year guidance, which still allows us to make necessary investments to service our customers, which remains our priority. Our pipeline remains robust, and we expect existing and new customer opportunities to benefit the second half of the fiscal year. We're encouraged by the improvements that we see within our operations as evidenced by the trends in staffing, fill rates and operating efficiency. We plan to continue deleveraging our balance sheet, and to finish fiscal 2023 with total net debt below fiscal 2022's ending balance driven by cash generated from operations as well as the benefits of A/R monetization. Our confidence in the business, and belief in our ability to increase shareholder value has led us to begin repurchasing shares, which we plan to continue to opportunistically pursue.

It continues to be an exciting time in UNFI. We remain confident that our strategy is working with tremendous improvement opportunities ahead of us, and we look forward to updating you on our progress in March.

Operator, please open the line for questions.

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QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] Our first question comes from John Heinbockel with Guggenheim.

John Heinbockel
Analyst, Guggenheim Partners

Q

So, Sandy, let me start maybe two longer-term questions. One, the changes to the merchandising organization, maybe talk to the key structural changes and what you think the benefits of that will be? And then secondly, when you think about the pace at which you can get automation rolled out, what's your thought process on that today versus maybe three months ago?

J. Alexander M. Douglas
Chief Executive Officer & Director, United Natural Foods, Inc.

A

Thanks, John. Good morning. The merchandising changes we made were we took our two strongest leaders who deal with suppliers end to end from procurement all the way down through working with customers in markets around the country. And we link them together with all of our regional merchandising organizations. And the idea is that our customers obviously operate locally. There are local opportunities that we are working with them on, on a regular basis. And what we've been working on is improving the link and visibility between local opportunity and the suppliers themselves, so that we can facilitate their ability to see the opportunity and facilitate their ability to invest in it and get a return, which creates a positive cycle in terms of growth. And the leaders are very experienced. They were in place, but we just made the organization much more seamless so the process works better.

Regarding automation, while our implementation schedule on automation is obviously competitively sensitive, the way I would think about that is, is that we will begin the implementation in fiscal 2023. We're going to learn a lot about that based on kind of working through the process. And then, we will implement as quickly as we can over the next few years, assuming that we can continue to validate the strong returns that John talked about, and the customer benefits that were designed to deliver through the automation initiative.

John Heinbockel
Analyst, Guggenheim Partners

Q

Great. And then, maybe my follow-up, if I think about your commentary on pipeline, right, maybe speak to your visibility now because it sounds like there is a good deal of visibility in the second half, your visibility maybe versus a quarter or two ago. And then, where is the visibility greatest, right, where do you think the impact? Is it going to be new customers? I know nothing is like key food, but new customers or new categories with existing customers, where is the visibility greatest?

J. Alexander M. Douglas
Chief Executive Officer & Director, United Natural Foods, Inc.

A

Sure. And John, we've been commenting in the five calls that I've been a part of about the strength of the pipeline. But obviously, one of the benefits of a pipeline is converting that to new customers or new categories, and as we did comment in the call we have visibility to that in the second half.

I would always want to say when talking about new opportunities though that the most important thing we focus on every day is our existing customers. Making sure that we're serving them well, we are merchandising with

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them well, and we're helping them compete and succeed in this environment. And probably the most positive thing about our pipeline is the majority of the opportunities are expansion with existing customers, which is good for a couple of reasons. First, it leverages our infrastructure that we're using to serve the customers, and secondly, because it reflects the healthy relationship that we're building. And so, I would say if you were to look at where the biggest opportunities that we see are and where our new-term visibility is, it would be more that kind of expansion with existing customers rather than new ones although there are some new ones as well.

John Heinbockel
Analyst, Guggenheim Partners

Q

Thank you.

Operator: Our next question comes from Leah Jordan with Goldman Sachs.

Leah Jordan
Analyst, Goldman Sachs & Co. LLC

Q

Hi. Good morning. Thank you for taking my question. First, I wanted to start off on gross margins. I saw they were down a little bit in the quarter. You've called out the mix shift to larger customers. Should we think about that pressure kind of persisting throughout the year or is there anything specific about this quarter that we should keep in mind?

J. Alexander M. Douglas
Chief Executive Officer & Director, United Natural Foods, Inc.

A

Thanks, Leah, for the question. I mean, effectively, we're focused on driving healthy growth and gross profit dollars. And the reason for that is that we look at every single one of our customer agreements with a disciplined eye for economic returns. A lot of our growth in the first quarter came with some of our bigger customers. But over time, I think you saw that all of our channels grew. And so, there'll be some fluctuation, but I would describe what you saw in the first quarter as minor and just more a function of the temporary growth drivers in our customer file.

Leah Jordan
Analyst, Goldman Sachs & Co. LLC

Q

Okay. Great. Thank you. And then, my follow-up is kind of around the top line, building a little bit off of that pipeline discussion. You guys have been pointing to kind of 4% top line growth for the year, a little elevated this first quarter. How are you thinking of the balance of food inflation and the outlook of that through the year with volumes as well as the new opportunities in the back half?

J. Alexander M. Douglas
Chief Executive Officer & Director, United Natural Foods, Inc.

A

Sure. Well, like all people in my line of work, we're interested in what the future holds in inflation but we are not economic experts, so. And I didn't just become one over the last month or two. I think from a growth perspective, we do expect that inflation will level off and moderate some in the go-forward periods. But our focus is on driving the things that we can control which is taking care of existing customers, merchandising well, and then activating our pipeline for growth. And from our perspective, our growth prospects against the $140 billion addressable market that we've identified is very strong.

The mix of inflation and elasticity and units, I mean our unit performance in the quarter was down 3%. We saw about 10% inflation. Down 3% was in line with the total industry, including some of the large-box retailers that

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have been driving growth because of value in the more recent past. And we're continuing to work really hard to make sure that our customers are as competitive as they possibly can be. And by virtue of that, that of course drives our ability to earn more business with them as we go forward. So, those are the pieces. The way they add up is in line with our guidance that we affirmed this morning.

Leah Jordan
Analyst, Goldman Sachs & Co. LLC

Q

Great. Thank you.

Operator: Our next question comes from Andrew Wolf with C.L. King.

Andrew Wolf
Analyst, C.L. King & Associates, Inc.

Q

Thank you. Good morning. Wanted to ask about industry-wide supply chain issues, which are noticeably not in your press release this quarter versus last year or so. So – and kind of context here is are we fastly approaching or are we kind of in a normal environment for the trade and how the trade is going to market up and down the supply chain?

And the second part of that is, so first the general observations on the supply chain and normalization. And secondly, assuming that's the case where we're approaching some type of normalization, with volumes down 3% for the industry, what are the manufacturers now that they can fill product reliably, but with negative volumes, what's their appetite for turning up their promotional spending through you and through the retailers directly?

J. Alexander M. Douglas
Chief Executive Officer & Director, United Natural Foods, Inc.

A

Hi, Andy. The way I'd describe the supply chain environment is that it's improving, and it's somewhat gradual. We talked a little bit about staffing being the best it had been since the beginning of last fiscal year. In fact, our supply chain vacancy rate is down to 6%, which is almost fully staffed. We saw marginal improvement in fill rates in the quarter sequentially from Q4 by about 1.5%, year-over-year about 4%, so I would say we're seeing improvement and stabilization, which has allowed us to activate the kind of supply chain program that you'd expect around improvement, process normalization, training, tactical use of technology, and then more strategic use of automation.

And that's why we are confident that with all those actions, we should see an improvement in our operating rates as we go forward, expense rates, and continue to see improvements in our service to our customers. And it just bears remembering the first quarter of last year which we're comparing to in this quarter, there was a lot of distress in the supply chain which got even worse in the second quarter. So, we've taken a lot of action around people, and recruitment, and staffing. Our first priority was making sure that we were serving our customers in a stable way, and in a reliable way. And I would say we've made some improvements. But I think, collectively our team and I working with our suppliers believe we have a very long way to go, and a rich l opportunity to improve going forward.

Regarding promotions, what we're seeing again in this environment is private label brands. Our own brand program performed very strongly in the first quarter, and we outgrew private brands in the broader market. We've added some brand and commercial talent to the private brands group, and we have made a significant priority to make that program significantly more competitive, and to sustain that kind of outperforming growth rate.

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Where all that comes back to our suppliers is through their strategies and our efforts to make customer opportunity more visible to them, we do expect promotions to improve sequentially. We hear that that's in many of their plans and we're continuing to want to make sure that they can see a good return from those investments, because in the end unit declines which equal [indiscernible] (00:33:20) is not good for their business over a sustainable basis. And so, we want to work really hard to attract that investment, and we expect it to improve going forward.

Andrew Wolf
Analyst, C.L. King & Associates, Inc.

Q

Thanks. And John, I believe it's probably for you, just a quick follow-up on the accounts receivable program you talked you quantified. I would guess that's pretty attractive financially, so I don't know if you could speak to any of the terms of that. But also kind of economically, if you're selling your receivables, which seemed like at least the internal activities around collections and accounting for receivables and stuff like that, at least some hours would come out if not some personnel. So, is there a direct bit of a economic advantage to the firm as well as whatever the financial aspects of it are?

John W. Howard
Chief Financial Officer, United Natural Foods, Inc.

A

Yeah, no, great question. So on the A/R monetization, all we did was monetize the receivables, the responsibilities for the credit and the collections, et cetera, that's still with UNFI. So, there's no additional productivity within our SG&A functions as a result of the A/R monetization. But what it does provide is just a way for us to reduce our cost of borrowing using the working capital that is tied up on our balance sheet. It is – by far, it's our cheapest borrowing option including our ABL, which has historically been our lowest borrowing option. So for us, it's just another tool for us to optimize our cost of capital, and it's relatively common within our industry, as you know.

Andrew Wolf
Analyst, C.L. King & Associates, Inc.

Q

Got it. All right. Well, thank you for that. Appreciate it.

John W. Howard
Chief Financial Officer, United Natural Foods, Inc.

A

Yeah. Thank you.

Operator: Our next question comes from Bill Kirk with MKM Partners.

Bill Kirk
Analyst, MKM Partners LLC

Q

Hey. Thanks for taking the questions. I want to go back to margins. If I remember 2Q of last year correctly, there was some rather significant COVID absenteeism that resulted in extra overtime pay, or even having to use some third party for the quarter. So, I guess as you're lapping that, how should we think about the incremental margin that would come back from the P&L if that type of disruption does not happen again?

J. Alexander M. Douglas
Chief Executive Officer & Director, United Natural Foods, Inc.

A

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So, Bill, this is Sandy here. What I would say is your recollection is obviously correct, and that's a little bit of a history that I was going over. What we saw in the first quarter of last year was buildings trying to run without enough people, and there was a fair amount of distress in our operating system. We were very focused then on addressing the vacancy issues, and then of course Omicron made the second quarter very difficult with the holidays, and so we had to rely on a lot of third-party labor.

As the year progressed, we've been able to replace third party to a large degree with our own employees, and we've seen some other inflation around buildings, and maintenance, and supplies, et cetera, but the net effect of that is that we saw that sort of peak in the fourth quarter of last year, and we sequentially improved in the first quarter versus the fourth quarter. And as John mentioned we expect, based on the programs we have, the comparisons, and more importantly the general staffing and improvement agenda that we have to see sequential improvements from the first quarter, which will start to compare more favorably the prior year in the second quarter.

Bill Kirk
Analyst, MKM Partners LLC
Q

Got it. And so, I had a follow-up also on the invoice factoring. You're doing it within the proceeds go to pay down debt, but it's happening I think right around the leverage ratio that would put a little restrictions on you. So, does the invoice factoring have anything to do with those – getting those covenant restrictions out of the way, getting that leverage down quickly, or is it as you've kind of said more cost of capital play?

John W. Howard
Chief Financial Officer, United Natural Foods, Inc.
A

It's more of a cost of capital play. From our perspective, the ability to monetize those and get that lowest cost of capital for us just economic value for UNFI and its shareholders is the primary focus.

Bill Kirk
Analyst, MKM Partners LLC
Q

Okay. So, it's not we needed a lower leverage ratio really quickly...

John W. Howard
Chief Financial Officer, United Natural Foods, Inc.
A

No.

Bill Kirk
Analyst, MKM Partners LLC
Q

...even quicker than the inventory return? Okay, okay. Thank you.

John W. Howard
Chief Financial Officer, United Natural Foods, Inc.
A

That is correct.

Operator: Our next question comes from Eric Larson with Seaport Research Partners.

Eric Larson
Analyst, Seaport Global Securities LLC
Q

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Yeah. Good morning, everyone. Thanks for taking my question. So, I just want to focus a little bit on retail. Your sales were up a little bit less than I think 2% in the quarter. And it just seems that given the inflation that we have in the industry, that number should have been a little higher. Is there something with the retail side? I know it's not a big part of your business, but I would have expected revenue to be little stronger there. Can you have some comments on that?

J. Alexander M. Douglas
Chief Executive Officer & Director, United Natural Foods, Inc.
A

Sure. I mean, our Retail business performed in line with our expectations in the quarter. I think one thing to keep in mind is that our Retail business is largely concentrated in one market, which is Minneapolis-St. Paul, and we are the market leader there, but it's a very competitive market, but we're excited with the plans we have for our brand. We'll be opening a couple of new stores. And the future we think is bright. The customer response to some of the new programming we have there has been positive. So, I would view that as a continuing profitable growth story, and we have positive expectations for both CUB and then Shoppers in the mid-Atlantic.

Eric Larson
Analyst, Seaport Global Securities LLC
Q

Yeah. And so on the Shoppers commentary, I think John said that you reacquired three Shoppers stores, and reopened them. I think it was actually dilutive a little bit to your EBITDA in the quarter. I'm assuming that's just like a onetime, this doesn't signal a change in strategy of how you want to approach retail, I'm guessing. So, I'm curious as to the reacquisition of those three Shoppers stores?

J. Alexander M. Douglas
Chief Executive Officer & Director, United Natural Foods, Inc.
A

Sure. Let me comment on the strategy, and then I'll let John confirm your question on EBITDA. But no, our strategy for retail hasn't changed. We are optimizing it that translates to driving profitable growth and optimizing the profitability. What we saw was an opportunity to reacquire three stores that we saw a growth opportunity in, and we decided to act upon it. But our strategy for optimizing retail for profitability and also as a learning lab for our business has not changed at all.

John, do you want to comment about the EBITDA?

John W. Howard
Chief Financial Officer, United Natural Foods, Inc.
A

Yeah, no, absolutely. And what you're suggesting, Eric, is exactly right. Those stores came right back in towards the end of Q3. We have to incur some of the startup costs just to get them back into the appropriate condition to open them up before the holidays. So, it is from a dollar or a rate perspective, it is dilutive just to incur those costs right at the end of the period.

Eric Larson
Analyst, Seaport Global Securities LLC
Q

Okay. Thanks, guys. Appreciate the commentary.

John W. Howard
Chief Financial Officer, United Natural Foods, Inc.
A

Yeah. Appreciate. Thanks, Eric.

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Operator: Our next question comes from Kelly Bania with BMO Capital.

Kelly Bania
Analyst, BMO Capital Markets Corp.

Q

Hi. Good morning. Thanks for taking our questions. Sandy, wanted to just go back to the discussion of volume and inflation. I think you cited a volume figure of down 3%. Just help – wondering if you could help us unpack how key foods is tracking relative to your expectations and maybe impacting that number. I'm just trying to kind of map to an underlying volume figure.

And just as you look at volumes also, just some more color about the categories that are working, or that are declining. Just a little deeper dive on the volumes here.

J. Alexander M. Douglas
Chief Executive Officer & Director, United Natural Foods, Inc.

A

Sure, Kelly. As you know we don't comment about individual customers. But the way I'd try to frame the minus 3% is obviously the consumers reacting to significantly high prices, and that's happening across the market, and so there is some negative elasticity there. Our system, if you think about all 32,000-plus outlets, are actually when you add them all together performing in line with the market that includes the big-box retailers and the club stores, et cetera.

As far as expected performance from past customer acquisitions, they are in line. Our customer profile is growing and it's healthy. And in fact as we mentioned earlier, we have some new growth on tap for the second half of the year. I think one thing I'd like to digress on for just a second and then see if you have a follow-up is that the reason why the customer file and gaining new customers and serving existing customers is so important is that as we drive its growth, obviously we get sales and profit growth out of it, but we also create an even more attractive opportunity for suppliers to invest to drive their growth across an incredible range of very innovative, very agile, locally, and regionally positioned retailers.

And that supplier investment is something that drives the retailers' competitiveness, drives our sales and profitability growth, and that then it allows us to make our cost more efficient in line and then in addition to the programming we had to drive process improvement, technology improvement, and ultimately automation improvements. So, the customer profile at UNFI is healthy. Our existing customers are completing like crazy across the country. And that's why, I spend so much time focused on it as a strategic priority in the business.

Kelly Bania
Analyst, BMO Capital Markets Corp.

Q

That's very helpful. I guess my follow-up would be just going back to this robust customer pipeline. I guess a couple of questions there. Is there any specific factors they you are thinking that maybe driving that or it's just a typical RFP kind of process? And what is baked into your guidance or would any new customer wins be upside to your guidance in the back half?

J. Alexander M. Douglas
Chief Executive Officer & Director, United Natural Foods, Inc.

A

Okay, Kelly, I'll let John comment on guidance. But what I would say is, and I mentioned this before, the driver of our pipeline improvement is going to be expansion with existing customers, which is the best kind of growth for the reasons I said earlier. And clearly, how we're servicing our existing customers is what drives that. Now, there are also new customer opportunities in our pipeline and as we've mentioned all the way back to Investor Day, we

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see a $140 billion of opportunity out there. So, you can find opportunities of every kind. But the short-term visibility that we have that's driving ours is expansion with existing customers.

John, do you want to comment about how that all figures in guidance?

John W. Howard
Chief Financial Officer, United Natural Foods, Inc.
A

Yeah, yeah, happy to, Sandy. The way we think about guidance, Kelly, is we come back to that core of the Fuel the Future, which is that we would grow faster than the market. And so, we have anticipated some of this within the guidance that we provided, and we're comfortable with where we are as Sandy and I said in our scripts, we're comfortable with where we are to affirm that guidance for FY 2023.

Kelly Bania
Analyst, BMO Capital Markets Corp.
Q

Okay. Thank you. And if I can just squeeze one more in, just on the services given that was a big focus back in the June meeting. I think I heard that services were up a double-digit. But can you share with us any metrics today how you are measuring the success of that? What percent of your customers are engaged? Which particular services are attractive in the current environment or are working? Just a little more color on the service strategy.

J. Alexander M. Douglas
Chief Executive Officer & Director, United Natural Foods, Inc.
A

Sure, Kelly. And you did hear right. We had a strong top line and double-digit bottom line growth in our services business in the first quarter. We have, as you know, added management focus to the services platform, which includes brands and services and e-comm, and the digital interface with our customers, and we're extremely bullish about it. It's part of that flywheel of our business because the more customers we have, the more demand we have for services.

In this environment, the way I would think of our over 100 services is they either help the customer drive their customer experience and growth or they help our customers save money. And I would say the latter is particularly important right now. And so, we see demand for a wide range of the services. We continue to create new services in response to customer demand. And with the leadership we put in place over services and brands, we're very bullish about the future of that part of our business, and obviously it's profitable for us because it creates lots of value for our customers. So, there is a strong economic reason for our attention there.

Operator: Our next question comes from Scott Mushkin with R5 Capital.

Scott Mushkin
Analyst, R5 Capital LLC
Q

Hey, guys. Thanks for taking my questions. So, Sandy, you've been in this business a long time, so have I. Question I keep getting from both buy-side customers and also our consulting clients is take us to the end of 2023, if the Fed is successful driving down inflation maybe, and we get some deflation in the unemployment rate up, what does the business look like?

J. Alexander M. Douglas
Chief Executive Officer & Director, United Natural Foods, Inc.
A

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It's a good question, Scott. I have had a lot of experience in this industry, but as an economist I am not. Look – but let me give you the core assumptions we're making. And that is that, this environment and the retail competitive environment is going to remain very intense. The one thing that's been true across all of my experience is that retailers are very innovative, they're agile, they change, and they compete incredibly hard with each other. So, whether we're dealing with inflation or supply chain challenges, the one thing the industry has built in the last three years, and I think UNFI has done a nice job of, is becoming more agile.

Our focus is increasingly on what do we need to be doing to create unique value for our customers to help them complete, grow and be more profitable. And that's what we're doing. And the interesting thing and one of the most exciting things for me as I joined UNFI 15 months ago is learning about our customer base and how they're segmented, they're ethnically segmented, they're top value, low value, they're regional, they're stores in small towns, and they represent a very, very dynamic group of retailers and a tremendous opportunity for suppliers because most of my experiences as you know was as a consumer products company person. And if I could have seen the customer opportunity that lies behind the UNFI support service into the retail community that we serve, it would have excited me to no end. And part of what we're doing now is working with our suppliers to help them see the customers that are there so that they can invest and get a great return.

So, I didn't really answer your question because I don't know the specific answer. But what I think we can assume is that it's going to be very competitive, and that it's going to be up to us to be increasing value added in day-to-day operations, and in the services and brands we provide. And then finally, what I would say is that we continue to see in the capability agenda that we talk about an immense opportunity for our own improvement, improvement that will drive more value for our customers, but also significantly more efficiency in our business to create more value for our shareholders. And that roadmap of opportunity for improvement continues to grow as I get more experience in this job.

Scott Mushkin
Analyst, R5 Capital LLC

Q

No, that's helpful. Maybe a little follow-up to that because you were talking about like the company-specific initiatives, the winning of business. If your core business or even the industries, I'm not really specifically thinking of UNFI, but like if your core, the core business is units down which it is right now, pricing down but labor cost up, which is really possible as we get through the end of the calendar 2023, it's possible, in a stronger possible. What can – I mean, is there enough in that – in your business to offset some of those negative trends? Is there enough juice there with the company initiatives, maybe some other cost coming down where that's okay? So, we had someone who said that's a disaster, not you guys but for the industry.

J. Alexander M. Douglas
Chief Executive Officer & Director, United Natural Foods, Inc.

A

Yeah. I mean, Scott, at this stage, I think there is a very significant relationship between prices being up strongly and the unit elasticity that's creating weakness in the units. If your scenario is that inflation starts to abate, the pressure on units year-over-year will also abate. Now, there is economic factors and there is competitiveness factors in and around retail, but I don't think that we are headed to a place where prices will be down and volume will be down. I see us in a place where price is up now, there's pressure, the economy is softer, there's pressure on consumers, and so elasticity is giving us a negative unit picture. But the consumer products companies will want to grow their business however their revenue management strategy guides them and that will include some combination of volume and price. And our job will be to manage that in the best possible way to keep our customers competitive.

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In parallel to that, as the supply chain incrementally stabilizes, and I think there's still, as I mentioned, a long way to go, we have in place a series of more progressive programs around process and technology and automation and improvement and efficiency that will keep our expenses improving in relation to sales on a sequential basis. So, we're going to play both sides of that. But at the heart of it is our ability to serve our customers and to have more customers and more categories as we go forward, which drives to flywheel that I talked about earlier.

Scott Mushkin
Analyst, R5 Capital LLC

Q

All right. Great color. I've more questions. I'll just take them offline. Thank you. Really appreciate it.

J. Alexander M. Douglas
Chief Executive Officer & Director, United Natural Foods, Inc.

A

Thanks. Thanks, Scott.

Operator: And our final question comes from Peter Saleh with BTIG.

Peter Saleh
Analyst, BTIG LLC

Q

Great. Thanks. Most of my questions were asked and answered. But I did want to come back to a comment you made earlier, Sandy, on value. I think you mentioned consumers are seeking more value these days, but not necessarily the lowest price. Can you elaborate on that, were you alluding to the private label or something else? Just trying to better understand that comment, and then I have one more follow-up. Thanks.

J. Alexander M. Douglas
Chief Executive Officer & Director, United Natural Foods, Inc.

A

Yeah. Sure, Peter. Yeah, I believe that – I mean everybody on this call understands that value is the relation of what you get versus what you have to pay. In this environment, I think it's important for consumers to have options, that's what our customers are telling us. Options can take the form of our private brands program, which I mentioned we're investing in to make sure that we have the private brand offer that gives our customers the products and brands that they will want to merchandise to give their shoppers the best possible choice given that retailer's merchandising strategy, and that's a huge part of our focus there.

The other comment I've made and I talked a little bit about changing and improving the way we do local merchandising back to our – linked all the way back to our suppliers gets into a little bit of how their portfolios are deployed and what their brand pack architecture is and how that changes as the month goes on. For example, later in the month right before Federal support comes out, we might need smaller packages being merchandised at lower price points just to help consumers where they are in the month.

So, there is a set of levers around value, but in the end our particular initiatives to support it, our private brands program and our merchandising improvement working with suppliers and our retailers to make sure that their offer fits their customer basic needs throughout the month.

Peter Saleh
Analyst, BTIG LLC

Q

Great. Thank you for that. And then just lastly, I think your prior guidance on inflation for FY 2023 was low- to mid-single digits. Does that still hold for this year or has that changed at all?

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John W. Howard
Chief Financial Officer, United Natural Foods, Inc.

A

Yeah. So, from my perspective by affirming guidance, we're basically maintaining that. That guidance for the inflation was for the full year that we talked about. We're one quarter end, we don't want to make any adjustments on that right now. We still anticipate how that inflation is going to play out for the next eight or nine periods, and baked into our affirmation of our guidance is a continued assumption.

Peter Saleh
Analyst, BTIG LLC

Q

Great. Thank you very much.

Operator: That concludes the question-and-answers portion of the call. I now turn the call back over to Sandy Douglas for his closing remarks.

J. Alexander M. Douglas
Chief Executive Officer & Director, United Natural Foods, Inc.

Thanks, operator. And thanks to everybody for joining us this morning. I hope you've heard and take away from today's call that UNFI continues its relentless focus on improving the service we provide our customers and has well thought-out plans to drive growth and efficiencies this year and beyond, all leading to strong returns for our shareholders. For our customers and suppliers, we thank you for your continued partnership and the business we do together.

For the UNFI associates listening today, our thanks to each of you for everything that you do for our business, our customers, our communities and each other. And for our shareholders, thank you for the continuing trust you place in us through your investment in UNFI. We look forward to updating you again after our second quarter.

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